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ECONOMIC SHIFTS RECONCILLING OBSERVATIONS AND RHETORIC WITHIN THE U.S. ECONOMY

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Déjà vu the Breakdown of Financial Confidence

For the American people, déjà vu arrived in December 2007, and for the former President of the United States, Barack Obama, it was when he was inaugurated on 20 January 2009, inheriting the worst financial crisis since the Great Depression of 1929. At the start of the 2007, financial crisis the United States (U.S.) was experiencing a boom in consumer spending. This came to an abrupt halt when the U.S. housing market collapsed resulting in an $8 trillion dollar housing debt and a steep decline in equity prices. Fallout from the housing crisis quickly spread to the broader economy through a complex web of unclear financial instruments tied to housing and dubious business practices of some financial firms. The resulting loss of wealth led to cutbacks in U.S. credit backed consumer spending. According to the U.S. Department of Labour[1], roughly, 8.7 million jobs were shed from February 2008 to February 2010, and GDP contracted by 5 percent, making this the Great Recession the worst since the Great Depression.

Faced with the ensuing meltdown of the financial and banking systems President Obama and his advisors were confronted with a number of tough economic decisions which embraced spending a lot of dollars to stimulate the U.S. economy, and paying out billions of dollars to stabilize the financial and banking systems, whilst trying to help unfortunate mortgage holders hang on to their properties,(to help stabilise financial markets, the U.S. Congress established a $700 billion dollar Troubled Asset Relief Programme (TARP) in October 2008). Over 700 banks received capital through TARP, and the Obama Administration also expanded the use of TARP funds to help millions of families affected by the housing crisis, restructure the automobile industry, and support for small businesses.

The catalyst for the Great Recession can be traced to the subprime housing market, when house prices began to fall. Although the Federal Reserve[2] was convinced, the mounting housing debt could be contained it soon became apparent the accumulating debt was having a major impact on the economy. Faced with growing mortgage debt many banks feared huge losses, when they realized they would have to soak up these losses they stopped lending to each other. The banks did not want other banks giving them worthless mortgages as collateral. This mistrust between banks exacerbated the financial crisis.

At the time of the crisis, personal consumption expenditures (PCE's) in dollar terms was 69.5 percent of GDP, therefore, consumer spending was a large and increasingly important part of the U.S. economy especially prior to the recession (and after, Table 1). Fearing the worst and on advice from the Federal Reserve President Obama initiated a bail out of several American banks and an economic stimulus package of nearly $800 billion dollars through the American Recovery and Reinvestment Act of 2009. The primary objective of the Act was to save existing jobs and create 3-4 million new ones, especially in the construction, health education, and energy sectors. Without action and the stimulus package, the U.S. economy may have experienced unemployment rates in excess of 10 percent.

Although there is, some difference of opinion, the Great Recession was considered to have slowed down and stabilised in 2009. To prevent a further occurrence the Obama government stepped in to regulate the financial markets. Congress passed the Dodd-Frank Reform Act[3] (2010) to prevent banks from taking on too much risk and protect consumers from overzealous lenders (under the U.S. Treasury Department, the Consumer Financial Protection Bureau (CFPB).The remit of CFPB is to regulate credit fees, including credit, debit, and mortgage underwriting and bank fees.

Table 1: U.S. Growth in Consumer Spending (1961-2010)

Average annual share of GDP (percent)	
Period	Consumer spending
1961-70	61.8
1971-80	62.5
1981-90	64.6
1991-00	67.3
2001-10	70.0

Source OECD statistics

Table 2: U.S. Average Annual Consumer Spending (2010-16)

Year	Spending in dollars
2010	48,109
2011	49,705
2012	51,442
2013	51,100
2014	53,495
2015	55,978
2016	57,311

Source Statista Database

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The Rejuvenation of Financial Confidence

As the 21st century began, the U.S. population was 282 million[4]. Americans were 75 percent white, and more male than female. Mass consumption, spurred by advertising and consumer credit, is a distinguishing characteristic of modern U.S. society. Since 1960, consumer spending has become the largest component of U.S. gross domestic product (GDP, Table 1). Consumer spending behaviours are not rigid, shifting from time to time as incomes rise or fall. Historically, high-income families spend more in absolute terms on culture, education and entertainment than do low-income families, but they also spend a lower share of their income for food and other necessities.

Since the end of the financial crisis, average annual consumer spending in the U.S. as steadily increased suggesting a return in economic confidence (Table 2). For middle class Americans who are not poor, access to credit is an important factor to sustaining a good standard of living. For many Americans credit allows them to furnish their homes, pay for education, and obtain a car without having to save for them. In that way, debt supports the U.S. economy. In essence, consumer debt contributes to economic growth. As long as the economy grows, borrowers can pay off this debt more quickly in the future.

The U.S Treasury manages U.S. debt through its Bureau of the Public Debt. The debt falls into two broad categories: Intra-governmental holdings and debt held by the public. Intra-governmental debt is around $5.5 trillion dollars. Public debt is estimated at around $14.8 trillion dollars giving a combined debt in excess of $20 trillion dollars.

Although U.S. debt continues to increase, the U.S. economy has grown by 20 percent and, as of the fourth quarter of 2017, real GDP was 15.2 percent above its level at the end of 2007, when the Great Recession began. The U.S. continues to use debt to finance short-term growth through boosting consumer and military spending. Of the $14.8 trillion dollar of public debt securities owned by Americans, at the end of 2017, almost half is owned by foreign governments[5] (Table 3), and investors. One-fourth is held by the Federal Reserve, as well as state and local governments. Fifteen percent is held by mutual funds, private pension funds and holders of savings bonds and Treasury notes. The remaining 10 percent is owned by banks and insurance companies.

Foreign holdings are primarily motivated by a desire for a liquid and stable store of value for foreign reserves; relatively few assets besides U.S. Treasury securities fill this role well. As a result of foreign acquisition of Treasury securities, the federal government must dispatch U.S. income abroad to those foreign purchasers. If the overall economy is larger as a result of federal borrowing (because the borrowing stimulated economic recovery for example), then this outcome may leave the U.S. better off overall on net despite the transfer of income abroad. In other words, without foreign borrowing, U.S. income would be lower than it currently is net of foreign interest payments[6].

Table 3: Major Foreign Holders of Treasury Securities

Country	Holdings in trillions of dollars (December 2017)
China (mainland)	1.185
Japan	1.062
Ireland	0.327
Brazil	0.257
Cayman Islands	0.246
United Kingdom	0.250

Source Department of the Treasury/Federal Reserve Board

As world's largest economy, some economists have argued that borrowing on this scale is unprecedented in modern economic history. Again, many economists are asking whether U.S. indebtedness to foreign powers might pose understated or hidden threats to the U.S. economy or even to U.S. national security. With China, alone holding almost $1.2 trillion in reserve assets there is some risk that the U.S. might be subject in the future to economic blackmail (a point which Barack Obama's successor to the White House, Donald Trump recently echoed). Clearly, the U.S. dependence on foreign borrowing is a considerable vulnerability in the event of shock, such an extreme national security breach that might slow the inflow of new funds into the U.S. Although opinions differ economically, the way government could reduce its reliance on foreign borrowing is by raising the U.S. saving rate, which could be done most directly by reducing budget deficits.

Perhaps the most compelling argument for the resurgence of growth in the U.S. economy is home investment. Arguably, economic growth begins with investment and ends with consumer spending, high rates of investment in the present make possible future consumer spending. In this context, consumer purchases drive higher economic growth and for this reason, all countries seek positive economic growth (or GDP). The apparatus of GDP are personal consumption, investment, government spending and net exports. These elements inform what a country is good at producing.

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That's because GDP is the country's total economic output for each year and is equivalent to what is being spent in that economy.

In the standard economic model of investment, a representative firm with constant returns to scale chooses the level of capital that will maximize its expected future profits. According to the economist Samuelson[7], investment, as an addition to the capital stock, increases when output growth is expected

to increase. According to this view, businesses invest because they expect consumers to buy their products in the future, not simply because they currently have high profits or substantial retained earnings.

The component which drives economic confidence is by fare business investment which goes towards creating new jobs and consumer goods. At the start of the Great Recession, (2008) business investment was in the region of $1.5 trillion dollars. In 2017, business investments stood at almost $3 trillion dollars, which is double its recession low and ahead of its 2006 peak of $2.3 trillion dollars[8]. During President Obama's, tenure the White House took steps to encourage high-quality investment throughout the recovery period, it pressed for a robust agenda that included investing in infrastructure, reforming the business tax code, expanding trade and foreign direct investment, and continuing to support innovation, manufacturing, and small businesses.

Economic Interdependence

The single most important determinant of living standards, across countries and over time, is labour productivity that is the amount of output a worker can produce in an hour of work. The recent slowdown in productivity growth has also been seen in almost all advanced economies. Average annual productivity growth in advanced economies slowed to less than 1 percent from 2005 to 2015. Productivity growth is critical to the long-term health of the U.S. economy because it is a necessary component of both potential GDP growth and real increases in household incomes, and living standards.

Economic growth is measured by a number of interdependent components which include productivity and capital intensity. A stable macroeconomic environment does not drive economic growth, but it is a necessary condition to promote productivity. Two of the most important challenges in macroeconomics today are: (i) understanding the causes of the recent slowdown in global productivity and (ii) understanding its future outlook. Historically, investment per worker-hour referred to as "capital intensity" has added nearly 1 percentage point to labour productivity growth, nearly matching the contributions of total factor productivity (TFP) to total labour productivity growth. However, since 2010, capital intensity has been a draw on productivity (Furman[9], 2015), Table 4.

Some U.S. observers argue that the slowdown in TFP growth reflects the reduced ability of the U.S. economy to benefit from technological advances. Fernald[10] (2014) argues that the recent subdued pace of productivity growth is merely the return to more normal rates following nearly a decade of extraordinary gains from information technology (IT) advancement. In contrast to this view, the U.S. major strength lies in its unique combination of exceptional innovation capacity, large market size, and sophisticated businesses. The country's innovation capacity is driven by collaboration between firms and universities, human capital (scientists and engineers), and company spending on Research and Development (R&D). The U.S. also benefits from flexible labour markets and an overall well developed financial sector.

Table 4: Sources of Productivity Growth, 1948-2007 vs. 2010-2015

Source	1948 – 2007	2010 - 2015
Labour composition	0.2	0.2
Capital intensity	0.9	-0.2
Total factor productivity	1.2	0.6
Percentage points, annual rates	**2.3**	**0.6**

Source adapted from Furman, 2015, U.S. Bureau of Labour Statistics.

As suggested, TFP captures the efficiency with which labour and capital are combined to generate output. This depends not only on businesses' ability to innovate, but also on the extent to which they operate in an institutional, regulatory, and legal environment. Research suggests that TFP growth in the U.S. can benefit especially from policies that promote investment in human capital and R&D. According to statistics provided by the OECD, since 2010, spending on research and development as a percentage of GDP as remained constant at about 2.7 percent (which represents 71 percent of business sector spending or $341 billion dollars). Business sector firm's decisions to invest in R&D are based on their return on capital to R&D which is generally higher than that expected of public sector investments. Because rates of return in the private sector are generally higher than the public sector, there is under investment in R&D. The gap between private and public sector rates of return is quite large. In part, this disparity can be attributed to the types of policy and regulations enforced by policy makers. U.S. policies that directly target R&D include direct funding of government R&D, universities or business, investing in human capital formation, patent protection laws and R&D tax breaks. Other policies, not directly targeted at R&D, which have a significant impact on the level of R&D investment, include competition policy and regulation[11].

Whilst there is little evidence which binds regulation levels to economic growth, supporters of regulation seem to argue that regularity rules have positive economic effects in the long run, saving

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organisations from violations that could cost them both financially and reputationally. Since the presidential election of Donald Trump there is a new wave of optimise amongst business leaders

focused on President Trump's ongoing pledge to reduce taxes and bureaucratic legislation. Whilst President Trump has provided $5.5 trillion in total tax cuts to the economy, the approval from U.S. bankers and financiers has been set aside for the Trump Administration's economic policy agenda ("America First policy"). As an example, the U.S. Treasury Department[5] has issued a series of reports calling for sweeping changes to rules required under the 2010 Dodd-Frank Reform Act, and a council set up to select firms that pose risks to the financial system is in the process of removing those companies from heightened federal oversight.

A Sense of Balance

The world's major economies are all growing for the first time since the Great Recession ended in 2009. Partly fuelled by an increase in domestic consumption the U.S. economy is performing well against other advanced economies. From March 2009 to November 2016, the S&P 500 index[12] increased 186 percent. The combination of rising employment and wages, recovering asset prices, and industrious efforts to pay down debts has left American households with their strongest net worth position since the crisis.

According to the most recent U.S. Census, the population of the U.S. is currently 325 million. With such a large and diverse population, with varied markets that provide domestic producers with the experience of knowing what American consumers want, has given the U.S. a comparative home advantage. As a result, over 70 percent of what the country produces is for personal consumption (Table 1). As an illustration, the U.S. is a world leader in the provision of automobiles, brewing, entertainment, food-processing, pharmaceuticals and telecommunications of which some 56 million workers are employed by firms with less than 500 employees.

U.S. small-medium enterprises (SMEs), account for a large share of both employment and number of enterprises. In the U.S. SMEs vary in size and are represented in all sectors of the economy, including manufacturing, services, farming, and other sectors. Part of the Trump Administration's tax incentives is to encourage a resurgence of entrepreneurship in SMEs. Whilst SMEs make significant contributions to the U.S. economy in terms of employment, job creation, and U.S. economic activity, as measured by gross domestic product (GDP). SME employment and contributions to GDP are concentrated in services sectors, followed by manufacturing and mining, and construction. SMEs tend to support domestic consumption rather than export consumption. SME exports contribute less than 5 percent to the SME share of GDP in 2017. Whilst there are many reasons, why firms fail to punch above their weight and achieve export revenue John Haltiwanger[13], explains that the decline in firm

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configuration and entrepreneurship has been especially pronounced in new start-ups especially in the high-technology sector. The decline in vitality is also evident in the U.S. labour market, with slower

geographic mobility and labour turnover only partly reflecting population aging and a higher share of older firms in the mix.

Although not absolute, the most likely beneficiaries to further employment opportunities in the U.S. are those geographical areas of the U.S. situated in high density metropolitan regions. The most likely industries to prosper are those associated with construction, fabricated metals, food processing, heavy machinery, and manufacturing. For example, The National Network for Manufacturing Innovation[14] is linking small businesses to capabilities they need to compete through the White House Supply Chain Innovation Initiative; and linking manufactures to opportunities to bring production back to the United States. As part of the initiative the Advanced Manufacturing Partnership (AMP) Steering Committee, (a working group of President Obama Council of Advisors in Science and Technology) called for new intermediary services to help small manufacturers adopt new technologies and expand into new markets and calls for a public-private investment fund to help high technology manufacturing start-ups scale from pilots and prototypes into full scale U.S. commercial production, ensuring what is invented in the U.S. can be made there.

Investment is not only a domestic issue, U.S. businesses invest in order to export to foreign markets and there are substantial cross-border investment flows. Arguably, U.S. banking and financial service firms are still the envy of the world; and again they arguably constitute one of the U.S. most successful export industries alongside aerospace, machinery, computers and oil based commodities. Measured in GDP the U.S. generated 12 percent of total output in 2017 (Table 5). Although services created a trade surplus of $244 billion dollars, in 2017, the U.S. imported more than it exported and is currently running an account deficient in the region of $550 - 600 billion dollars. Partly due to the strength of the dollar and the U.S. continued reliance on oil and petroleum products, which means it will be difficult to break out its trade deficit in the short-medium term. This trade deficit is damaging to the nation’s economy especially when financed with debt. To reduce its trade deficit the U.S. needs to sell more to the rest of the world and this is a key agenda item for the Trump Administration to increases jobs, and reduces wage differentials and raise the standard of living for its residents.

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Table 5: Top 5 U.S. Imports and Exports (2017)

TOP 5 IMPORTS		TOP 5 EXPORTS	
Import Type	$ Value billions	Export Type	$ Value billions
Electrical machinery, equipment	356.8	Machinery including computers	201.7
Machinery including computers	349.1	Electrical machinery, equipment	174.2
Vehicles	294.6	Mineral fuels including oil	138.0
Mineral fuels including oil	204.2	Aircraft, spacecraft	131.2
Pharmaceuticals	96.4	Vehicles	130.1
	Total 1301.1		**Total 775.2**

Source Worlds Top Import/Exports: WTEx Database

The American consumer suffering from a decade of wage suppression, has had to stretch their disposable income, struggling to maintain their living standard they have turned to buying goods from countries like China, and Mexico. Which meant buying foreign cars, and lots of consumer electronics such as cell phones, TVs, and computers mostly made outside the U.S. For example, China, Mexico, Japan and Germany account for the bulk of the U.S. trade deficit. The trade deficit with China in goods is a major issue for President Trump, commenting, *"The situation is out of control"*. Whilst there are different, economic instruments for reducing trade deficits for example, tariffs, reducing the exchange rate, or import quotas (to keep the flow of goods equal). President Trump sees tariffs (taxes) as the way forward imposing $60 billion dollars on Chinese goods, under the Trade Representatives section 301, U.S. investigation into alleged misappropriation of US intellectual property by China. The new import duties will target industrial sectors where China has sought to acquire an advantage through the unfair acquisition or forced technology transfer from US companies. The downside (or upside) for the U.S. economy is the distinct possibility of a global trade war.

A further concern for the Trump Administration is U.S. competitiveness. As a major trading nation within the global economy, the U.S. can ill afford to lose its competitive advantage. Importing too many manufactured products over a long enough period of time, affects competitiveness. Companies begin to lose their expertise and even the invested returns to make those products. Although still ranked 3rd in global competitiveness, since 2007, the U.S. economy has been falling behind both in absolute and relative terms in infrastructure, macroeconomic environment, and goods market efficiency. Stagnating productivity has called for a downward revision of U.S. growth prospects, highlighting the need for a renewed competitiveness agenda. Dr Richard Florida[15] argues that human capital in the U.S.is under utilised by as much as 60 percent. Dr Florida advises economic progress

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within the U.S. depends on harnessing and tapping the creativity of each and every American citizen. A point echoed by U.S. Senator Chris Coons, who argues for increased support for innovators and entrepreneurs to acquire the funding and non-financial support they need to turn their ideas and innovations into the next revolutionary breakthroughs that can be seen in the marketplace.

Moving Forward

The Great Recession of 2007, revealed a number of imperfections in the U.S. financial system. Banks were woefully and inadequately capitalised, did not have enough liquidity, and took too many risks. The Obama Administration sought to rectify the situation and rebuild the economy by injecting billions of dollars into the financial system to ward off a collapse of the system. The Administration took steps to make the financial system safer, through the Dodd-Frank Reform Act, which helped correct a number of market failures that arose during the crisis. Through the Dodd-Frank Reform Act, there is today improved transparency, accountability, and consumer protections in U.S. financial system.

Post Dodd-Frank, the U.S. economy is much stronger with continued growth in GDP and investment. The economy has grown by more than 10 percent since 2008 and by more than 13 percent from its recession low point in 2009. Future growth in GDP will be influenced by President Trump’s policy measures and his “America First” policy. The Trump Administration is dealing with a number of key issues such as how to reduce its monumentus trade deficit with China without creating a global trade war. In Trump’s vision, mitigating the trade deficit serves the American people (and his power base); however, as a strategy it is heavily reliant on cooperation from other internal agencies. Addressing the deficit involves building flexibility to current and future impacts on productivity and competitiveness, developing alternative strategies and preparing for the changing occurrence and severity of policy outcomes and their consequences must be a key consideration for the Trump Administration (only time will tell).

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